(2)

No. 96-454

In the Supreme Court of the United States

OCTOBER TERM, 1996

ASSOCIATES COMMERCIAL CORPORATION, PETITIONER

v.

ELRAY RASH AND JEAN RASH

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING PETITIONER

WALTER DELLINGER
Acting Solicitor General
LORETTA C. ARGRETT
Assistant Attorney General
LAWRENCE G. WALLACE
Deputy Solicitor General
KENT L. JONES
Assistant to the Solicitor General
GARY D. GRAY
PAULA K. SPECK
Attorneys
Department of Justice
Washington, D.C. 20530-0001
(202) 514-2217

13 pp

QUESTION PRESENTED

Whether, when a debtor in a bankruptcy case is permitted to retain property that secures the claim of a secured creditor, the allowed amount of the secured claim is to be valued under Section 506(a) of the Bankruptcy Code at (i) the amount the creditor would realize from a hypothetical foreclosure sale of the property or (ii) the fair market value of the property in the hands of the debtor.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

In the Supreme Court of the United States

OCTOBER TERM, 1996

No. 96-454

ASSOCIATES COMMERCIAL CORPORATION, PETITIONER

v.

ELRAY RASH AND JEAN RASH

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING PETITIONER

INTEREST OF THE UNITED STATES

This case concerns whether, when a debtor is permitted to retain property that secures the claim of a secured creditor, the allowed amount of the secured claim is to be reduced, under Section 506(a) of the Bankruptcy Code, to the amount that the creditor would have obtained in a hypothetical foreclosure sale. This issue is of substantial importance to the United States. The United States often becomes a secured creditor under federal programs involving loans, loan guarantees, contracts and tax collection activities. The rights of the United States as a secured creditor are frequently affected by valuations of collateral under Section 506(a). Indeed, the court of appeals acknowledged that its decision in this case conflicts directly with the decision of the Ninth

Circuit in *Taffi* v. *United States*, 68 F.3d 306 (1995), aff'd on rehearing en banc, Nos. 94-55011 & 94-55019 (Sept. 17, 1996), which involved a similar effort by a debtor to reduce a secured claim of the United States to the amount that would be obtained in a hypothetical foreclosure sale.

The opinion of the court of appeals in this case not only conflicts with the en banc opinion of the Ninth Circuit in *Taffi* v. *United States*, *supra*. As petitioner notes (Pet. 6-8), it also conflicts with decisions of the First, Fourth, Sixth, and Eighth Circuits. As a result, the United States and its agencies will now face disparate treatment in different circuits of identical claims arising under national programs. The United States has a substantial interest in the resolution of this recurring conflict.

STATUTORY PROVISIONS INVOLVED

Section 506(a) of the Bankruptcy Code, 11 U.S.C. 506(a), provides:

> An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

STATEMENT

1. In 1992, respondents Elray and Jean Rash filed for bankruptcy under Chapter 13 of the Bankruptcy Code (Pet. App. 110a). Petitioner Associates Financial Commercial Corporation had provided purchase money financing to respondents and held a lien on a truck that respondent Elray Rash used in his business (*id.* at 111a). Over petitioner's objection, respondents proposed a plan under which (i) respondents would retain the truck for use in the continued operation of the business and (ii) the amount of petitioner's allowed secured claim would be reduced to the wholesale value of the truck (*id.* at 2a, 111a).[1]

The bankruptcy court approved the plan and also approved the debtor's valuation of petitioner's allowed secured claim. The court found that the truck had a wholesale value of $31,875 and a retail value of $42,500 (Pet. App. 111a). The court concluded that, under Section 506(a) of the Bankruptcy Code, the "allowed secured claim" should be valued at the wholesale value of the truck because "wholesale value most often equates to the value in the hands of the creditor after he has deducted his foreclosure and disposition costs so that it is a reasonable indication of the net proceeds he will receive upon the disposition of the

---

[1] The plan proposed by respondents was a "cramdown" plan, under which the debtor seeks confirmation of a plan despite a secured creditor's objections. In a "cramdown" plan, the amount of the secured claim is reduced to an "allowed secured claim" under the valuation provisions of Section 506(a) of the Bankruptcy Code, 11 U.S.C. 506(a). The portion of the secured claim that is not treated as an "allowed secured claim" under that provision is to be treated as an unsecured claim. *Ibid.* The creditor retains a lien to protect its secured claim. See 11 U.S.C. 1129(b), 1325(a)(5)(B)(i) and (ii).

reclaimed collateral" (Pet. App. 113a). The district court affirmed the bankruptcy court's orders (*id.* at 83a-88a).

2. a. A panel of the court of appeals reversed (Pet. App. 100a-109a). The panel held that, under Section 506(a) of the Bankruptcy Code, the value of the allowed secured claim was the retail or replacement value of the truck in the hands of the debtor, not the wholesale value of the truck (Pet. App. 109a).

b. Respondent filed a petition for rehearing en banc. While that petition was pending, the First, Eighth, and Ninth Circuits issued decisions that agreed with the reasoning and conclusion of the panel decision in this case and with an earlier decision of the Fourth Circuit on this same issue. See pages 5-6, *infra*.

In an en banc decision in which nine judges joined and six judges dissented, however, the Fifth Circuit rejected the panel decision and held that the value of the allowed secured claim must be limited to the wholesale value of the truck—the theoretical amount that the creditor would realize at a hypothetical foreclosure sale (Pet. App. 14a, 51a).

ARGUMENT

The decision of the court of appeals in this case creates a confict among the circuits on a recurring question of substantial importance. Resolution of this issue by this Court is needed to avoid repetitive and wasteful litigation and to ensure evenhanded treatment of debtors under the many federal programs that authorize or establish secured claims for the United States, as well as evenhanded treatment of debtors and secured creditors generally.

1. This case involves the proper valuation of a secured claim in a bankruptcy case when the debtor is permitted to retain the property that secures the claim. When, as in the present case, the debtor proposes to retain such property under a plan to which the secured creditor has objected, the court may approve the plan only if, among other requirements, it ensures that the holder of the secured claim will receive at least the value of the "allowed amount" of the "allowed secured claim." 11 U.S.C. 1325(a)(5)(B). See also 11 U.S.C. 1129(b)(2)(A)(i). The "allowed amount of such claim" is determined under Section 506(a) of the Bankruptcy Code, 11 U.S.C. 506(a). H. R. Rep. No. 595, 95th Cong., 1st Sess. 415 (1977). That Section specifies that a secured claim is to be treated as an "allowed" secured claim only to the extent of "the value of such creditor's interest in the estate's interest in such property" (11 U.S.C. 506(a)). The statute specifies that "[s]uch value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property" (*ibid.*). To the extent that the secured claim exceeds the value thus determined, it is treated as an unsecured claim (*ibid.*).

With the exception of the decision of the Fifth Circuit in this case, all of the courts of appeals that have interpreted the valuation provisions of Section 506(a) have rejected using "foreclosure value" as the measure of value when the debtor retains the collateral. These courts include the Eighth Circuit (*Metrobank* v. *Trimble*, 50 F.3d 530 (1995) (Chapter 13 case valuing pickup truck)), the First Circuit (*Winthrop Old Farm Nurseries, Inc.* v. *New Bedford Institution for Savings*, 50 F.3d 72 (1995) (Chapter 11 case valuing real property used in business)), the

Sixth Circuit (*Huntington National Bank* v. *Pees (In re McClurkin)*, 31 F.3d 401 (1994) (Chapter 13 case valuing real property used as residence)) and the Fourth Circuit (*Brown & Company Securities Corp.* v. *Balbus*, 933 F.2d 246 (1991) (Chapter 13 case valuing real property)); *Coker* v. *Sovran Equity Mortgage Corp.*, 973 F.2d 258 (1992) (same)).

Less than two months after the Fifth Circuit issued its en banc opinion in this case, the Ninth Circuit, also sitting en banc, joined the majority of the circuits by holding unanimously that, when the debtor retains the property that secures the secured claim, Section 506(a) does not permit reduction of the allowed amount of that claim to the foreclosure value of the property. Instead, the Ninth Circuit held that, in this context, the bankruptcy court is to value the allowed secured claim at the fair market value of the property. *Taffi* v. *United States*, Nos. 94-55011 & 94-55019 (Sept. 17, 1996).[2] Noting its disagreement with the en banc decision of the Fifth Circuit in this case, the *Taffi* court held (slip op. 12,713-12,714):

> When a Chapter 11 debtor or a Chapter 13 debtor intends to retain property subject to a lien, the purpose of a valuation under section 506(a) is not to determine the amount the creditor would receive if it hypothetically had to foreclose and sell

[2] As the Ninth Circuit held in *Taffi*, the contrary conclusion reached by the Fifth Circuit in the present case effectively ignores—and makes surplusage of—the statutory command that the value of the allowed secured claim "shall be determined in light of * * * the proposed disposition or use of such property" (11 U.S.C. 506(a)). See also H.R. Rep. No. 595, *supra*, at 356 (" 'Value' does not necessarily contemplate forced sale or liquidation value of the collateral; nor does it always imply a full going concern value.").

> the collateral. Neither the foreclosure value nor the costs of repossession are to be considered because no foreclosure is intended. * * * Valuation must be accomplished within the actual situation presented. Consequently, the value has to be the fair market value of what the debtors are using.

The conflict between the en banc decision of the Fifth Circuit in this case and the decisions of the First, Fourth, Sixth, Eighth, and Ninth Circuits is direct and irreconcilable. Unless resolved by this Court, this conflict will produce wasteful and repetitive litigation and will result in disparate treatment of secured claims in bankruptcies based solely upon geographical happenstance.

2. a. The question presented in this case is of substantial importance. As the petition notes, more than 286,000 Chapter 13 petitions were filed in 1995 (Pet. 15). The Internal Revenue Service advises us that during fiscal year 1996 (ending September 30, 1996) the Service received notice of 14,034 filings under Chapter 11 of the Bankruptcy Code and 151,174 filings under Chapter 13 of the Code. The Service filed proofs of claim in approximately 162,000 bankruptcy cases during that fiscal year. Approximately 7 percent of these claims (11,340) were filed in Chapter 11 cases and approximately 79 percent (127,980) were filed in Chapter 13 cases. The proofs of claim filed by the Internal Revenue Service during that single fiscal year asserted $329,830,957 in secured claims in Chapter 11 cases and $334,812,254 in secured claims in Chapter 13 cases.

The United States is also a secured creditor in a variety of other contexts. To list only a few examples, the United States may assert liens for payment

of penalties under agricultural quota programs and for the repayment of agricultural loans (7 U.S.C. 1314(c), 1339(a)(1), 1340(4), 1927(c)), for repayment of advances made under defense contracts (10 U.S.C. 2307(d)), for payment of certain criminal fines (18 U.S.C. 3613(c)), for payment of customs duties (19 U.S.C. 198), for payment of a judgment lien in favor of the United States in a civil action (28 U.S.C. 3201(a)), for payment of pension benefits under the Employee Retirement Income Security Act (ERISA) (29 U.S.C. 1368(a)), for repayment of black lung benefits (30 U.S.C. 934(b)(2)), for repayment of advances made to a contractor by a government agency (41 U.S.C. 255(d)), for repayment of low-income housing loans (42 U.S.C. 1484(a)(5), 1487(d)(1)), for payment of the costs of removing or remediating hazardous substances (42 U.S.C. 9607(l)(1)) and for payment of charges due under a federal irrigation project (43 U.S.C. 542).

The United States is thus a secured creditor in a large portion of all Chapter 11 and Chapter 13 bankruptcy cases. If the secured claim of the government in these cases were reduced under the foreclosure valuation method endorsed by the court of appeals in this case, the loss of revenue to the Treasury would be substantial.

b. Because of the conflict among the circuits created by the decision in this case, two taxpayers who owe the same amount of tax and possess assets of the same value ultimately may pay significantly different amounts of their federal tax liability depending solely upon the happenstance of geography. This disparate treatment impedes the objective of "ensur[ing] as far as possible that similarly situated taxpayers pay the same tax." *Thor Power Tool Co.* v. *Commissioner*, 439 U.S. 522, 544 (1979). See also *Lyeth* v. *Hoey*, 305 U.S. 188, 193 (1938). It similarly prevents the uniform application of all other federal programs that authorize or create secured claims for the government.

Review by this Court is warranted to resolve the continuing conflict among the circuits on the common, recurring question presented in this case.

CONCLUSION

The petition for writ of certiorari should be granted.

Respectfully submitted.

WALTER DELLINGER
Acting Solicitor General
LORETTA C. ARGRETT
Assistant Attorney General
LAWRENCE G. WALLACE
Deputy Solicitor General
KENT L. JONES
Assistant to the Solicitor General
GARY D. GRAY
PAULA K. SPECK
Attorneys

OCTOBER 1996